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BlogSpot - Eurozone: QE's mixed picture

By Marie Rouger - February 2nd, 2015

The ECB's highly anticipated Quantitative Easing (QE) program (see our previous [Warning Signals BlogSpot](#)) was [announced by Mario Draghi](#) to revive growth and fight deflation in the Eurozone. Larger than expected, it plans to provide an additional 50 billion per month from March 2015 to at least September 2016, staying open-ended as long as inflation does not reach its "below but close to 2%" target. QE includes purchases of investment-grade government, national agencies and EU institutions bonds, in addition to its existing purchases of covered bonds and asset-backed securities. The program organizes a limited risk-sharing, since 80% of purchases are to be made by National Central Banks.

A welcome "surprise" in size

For [Guntram Wolff and Silvia Merler](#), the asset purchase is larger than expected in size (above the 500-700 billion range expected before the announcement) and in maturity (from 2 to 30 years maturity bonds), though [Open Europe Raoul Ruparel](#) underlines that the amount purchased remains below the 27.5% and 21% of debt markets purchased in the UK and in the US, respectively.

Early optimism and potential impact—Immediate market reaction followed the announcement, with stock prices increases and further euro depreciation. [Jeffrey Sachs](#) argues that pre-QE stock market outperformance reflect growing confidence, and works as a direct channel by which monetary easing can boost both investment and consumption. [Stephen Roach \(Project Syndicate\)](#) disagrees on this last point, reminding that QE's wealth effect channel (i.e. boosted asset prices increasing investors' wealth to restore consumption and therefore growth) may not work for Europe as it did for Japan and the US, because of Europe's low share of individuals-owned equity. Europe would rather rely on other monetary policy channels, especially the banking channel and the currency channel, since a weaker euro would boost exports and produce (imported) inflation. [Capital Economics](#) agree on that point, insisting that a weaker currency is the primary channel through which QE might work in the euro zone.

Complementarities—[Jeffrey Sachs](#) welcomes QE's combination to the Juncker investment plan, arguing that monetary policy needs a synchronous demand stimulus to be effective.

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Questioning QE's effectiveness

Credibility & confidence: Will the signal channel last? Doubtful on QE's implementation choices, [Raoul Ruparel](#) (OpenEurope) questions the apparent contrast between the expressed "open-endedness" of ECB's program and its promise not to purchase more than 33% of any given debt market; this vagueness may have misleading consequences.

Limits to the "rebalancing channel": For Alberto Gallo ([RBS Silver Bullet](#)), the hope from policymakers is that investors may move out of investment grade bonds, in shrinking supply, into riskier asset classes—but he sees limited upside from this channel as investment mandates are constrained. The result is a shrinking market and good returns for bondholders, but little trickle-down effect in the real economy. In Europe, bank assets are €31tn, while all investment grade bonds (sovereigns and corporates) less than €10tn—the search for yield reaches only a fraction of the economy. He sees the risk of a "black hole", where QE and low interest rates are used as the only stimulus against the crisis, yet because this is not credible to economic participants, these continue to de-lever and focus on debt minimization rather than profit maximization.

Doubts on QE's transmission to the real economy. Though the ECB managed the expected QE's double challenge (think big, and minimize risks), [Raoul Ruparel](#) (OpenEurope) claims that the program may not have a sizeable impact on the real economy because it over-relies on a banking credit channel that may not work. He also questions the effectiveness of the portfolio rebalancing channel (from government bonds to corporate bonds), highlighting that investors' decisions are more about regulatory and risk-balancing issues than liquidity issues and therefore may not be influenced, even by a QE of this size. Finally, Ruparel is doubtful about QE's ability to boost European exports. Taking the example of Japan in 2012, he even warns that it may eventually hamper the level of investment in the Eurozone. [Sachs](#) also writes that QE cannot produce long-term growth.

Does risk-sharing hamper effectiveness? In a [Bruegel](#), Guntram Wolff and Silvia Merler express concern on the effectiveness of the program given that the ECB has substantially reduced risk sharing. On the contrary, [OpenEurope](#) believes that the practical effect is the same as if the ECB took entire responsibility.

Rising concerns

Political implications. Following the ECB's decision of limited risk-sharing, [Guntram Wolff and Silvia Merler](#) claim that we can rightly question whether monetary policy is "single". Georges Friedman, in a [Stratfor article](#) sees the EBC's QE decision as a sign of rising nationalism in Europe so that European countries would not have to bear the

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debt of others. [Marco Annunziata](#) is more optimistic, considering it as a positive reminder that additional steps towards fiscal union are needed. [Ruparel](#) raises the issue of potential disagreements between the ECB and the National Central Banks, questioning whether the ECB may be able to force the National Central Banks into purchases they refuse to conduct. This issue is particularly relevant as some National Banks are opposed to purchases, notably Germany.

QE's uneven effects may also increase divisions between member states. [OpenEurope](#) highlights that the program may not benefit all member countries in the same way—as a large part of their central government debt may be purchased, Germany, Portugal and Spain could benefit from the program more than others (France, for instance).

Germany's reluctance to QE. [Angela Merkel](#) declared that QE's relieving impact should not result in the belief that reforms could be delayed, a message relayed by the head of the German Chambers of Commerce and Industry [Martin Wansleben](#). QE also raises legal concerns and divisions in the Eurozone, just as the [OMT](#) before.